



INDONESIA: ECONOMIC AND FINANCIAL HIGHLIGHTS OCTOBER - NOVEMBER 2006

Summary:

- The Central Bureau of Statistics (BPS) announced on November 16 that Indonesia's GDP growth reached 5.5% in the third quarter of 2006 on a year-on-year (YoY) basis, the highest quarterly growth rate since the third quarter of 2005.
- YoY consumer price inflation (CPI) dropped significantly to 6.3% in October and 5.3% in November as the BPS's inflation calculations incorporated the effects of the October 2005 fuel price hikes.
- Bank Indonesia (BI) cut its policy rate by 50 basis points on November 7, bringing the BI rate to 10.25%.
- On November 16, the Government of Indonesia (GOI) sold its remaining shares in Bank Internasional Indonesia (BII) and Lippo Bank for Rp 514 billion (US\$ 56 million).
- As part of a restructuring of the Ministry of Finance, on November 1 Minister of Finance Sri Mulyani Indrawati swore in ten new senior officials, including a new Secretary General and five new Directors General.
- On November 29, Parliament confirmed Muliaman D. Hadad and Budi Rochadi as BI Deputy Governors, replacing Maman H. Soemantri and Maulana Ibrahim.
- On October 5, BI issued a new policy package designed to promote consolidation in the banking industry.
- The GOI repaid the remainder of Indonesia's SDR 2.1 million (US\$ 3.2 billion) outstanding loans to the IMF on October 12.
- On October 10, the Ministry of Finance (MOF) auctioned Rp 1 trillion (US\$ 109 million) in 2-year treasury bonds with a coupon rate of 9.25%, and on October 17, the MOF swapped bonds totaling Rp 4.3 trillion (USD 469 million) as part of its bond re-profiling program.
- Indonesia and China agreed on an expanded, US\$ 4 billion debt swap program under the Chiang Mai Initiative on October 17.
- Fitch Ratings affirmed on November 1 the ratings of Bank Central Asia (BCA), Bank Rakyat Indonesia (BRI) and Bank Niaga, Indonesia's second, fourth, and seventh largest banks respectively.
- Bank Permata and Lippo Bank issued subordinated debt in November 2006 totaling US\$ 255 million.

GDP Growth Accelerates While Inflation Slows

On November 16, BPS announced that Indonesia's economy expanded by 5.5% YoY in the third quarter, the highest growth rate since the third quarter of 2005. Strong growth in exports drove the expansion in GDP, with exports of goods and services rising 12.1% YoY during the quarter. On November 1, BPS announced that Indonesia's headline CPI inflation had dropped to 6.3% in October 2006 from 14.5% in September as the agency's CPI calculations incorporated the effects of the October 2005 fuel price hikes. YoY inflation in November fell further to 5.3%. Month-on-month (MoM) inflation in November fell to 0.3% from 0.9% MoM in October, as price increases linked to the Idul Fitri holiday in late October moderated. Transportation and communication prices rose in October and November by only 1.7% and 1.0% YoY, respectively, compared with the 30.2% YoY rise recorded in September. Pressure on prices also eased for a number of other segments. Housing costs lost momentum, increasing by the slowest rate in more than six and a half years at 4.4% YoY in November. Growth in food prices eased to 8% YoY in November, down from 15.5% YoY and 10.0% YoY in September and October, respectively. Core inflation also slowed to 5.9% YoY in November, down from 6.9% and 9.2% YoY in the previous two months.

Inflation Eases Further in August

On October 2, the Central Bureau of Statistics (BPS) announced that Indonesia's month-on-month (MoM) inflation increased slightly to 0.38% in September with the beginning of the Muslim fasting month compared with 0.33% in August. However, YoY inflation for the month eased for a fourth consecutive month to 14.55%, the lowest reading in a year. All components of the consumer price index except foodstuffs and education demonstrated slower price growth in September compared to August. Core inflation went up by 0.35% MoM, and 9.13% YoY in September, compared to August's 0.78% and 9.68% respectively. Though demand for goods and transportation traditionally increases due to Muslim and Christian holidays in the fourth quarter, analysts remain optimistic that YoY inflation will fall to 7% by the end of 2006.

CPI Components

Components	October		November	
	MoM	YoY	MoM	YoY
Food stuff	2.2	10.0	0.7	8.1
Food, beverages, tobacco, cigarettes	0.7	7.5	0.5	5.9
Housing, water, electricity, oil/gas	0.3	4.8	0.3	4.4
Clothing	1.0	7.2	0.7	7.6
Health	0.3	5.6	0.4	5.4
Education, recreation, and sport	0.1	8.3	0.0	8.0
Transportation, communication, financial services	0.5	1.7	-0.2	1.0
TOTAL	0.9	6.3	0.3	5.3
Core Inflation *	0.7	6.9	0.3	5.9

Source: Central Bureau of Statistics (BPS)

* Core inflation is a measure of inflation which excludes certain items that face volatile price movements i.e. energy, food products.

BI Cuts Reference Interest Rate to 10.25%

For the sixth time since May 2006, BI cut its policy rate 50 basis points to 10.25% at its November 7 monetary policy meeting. The move followed a 50 basis point cut on October 5. Following the November 7 rate cut, Finance Minister Sri Mulyani commented that “with the sharp slow down in inflation, BI has room to cut rates without worrying about reigniting price increases.” However, in its statement released after the meeting, BI cited “economic concerns calling for vigilance in the months ahead” including continued inflationary pressure in 2007. BI added that “the Board of Governors...sees the need for more measured, cautious operation of monetary policy to maintain macroeconomic stability in the medium and long-term and consolidate the momentum for sustainable economic recovery.” Most analysts expect BI to continue to reduce interest rates through the end of 2006, although there is less agreement on the pace of likely future interest rate cuts.

GOI Divests its Ownership of Two Banks

On November 16, the GOI, through its Asset Management Company (PPA), earned Rp 514 billion (US\$ 56 million) from the divestment of a 5.22% stake in BII and a 0.0012% stake in Lippo Bank. With the sales, the GOI has divested its remaining stakes in all but two banks, Maybank (6.08%) and BTPN (28.39%).

MOF Replaces Senior Officials

On November 1, Minister of Finance Sri Mulyani Indrawati swore in ten new senior or “echelon one” officials at the Ministry. As part of the move, the Minister formally expanded the number of Directors General (DGs) at the Ministry from five to seven, creating new DGs for Debt Management and State Assets. The new structure is designed

to strengthen the Ministry's debt management and budget execution functions. Table 2 lists the names and titles of the new officials.

Ministry of Finance – New Senior Officials

	Previous Position	Current Position
Mulia P. Nasution	Director General (DG) for State Treasury	Secretary General
Rachmad Rocjadi	DG for Budget and Balanced Funds	DG for Budgetary Affairs
Herry Purnomo	Director for State Assets	DG for State Treasury
Hadiyanto	Head of Legal Bureau	DG for State Assets
Mardiasmo	Special Advisor on Government Spending	DG for Balanced Funds
Rahmat Waluyanto	Director for Debt Management	DG for Debt Management
Permana Agung Daradjatun	Special Advisor on State Assets	Inspector General
Eddie Abdurrachman	Former DG of Custom and Excise	Special Advisor on International Affairs
Agus Muhammad	Inspector General	Special Advisor on State Assets
Marwanto	Head of Public Affairs Bureau	Special Advisor on Government Spending
Anggito Abimanyu	Head of Fiscal Policy Agency	Acting Head of Fiscal Policy Agency

Source: Minister of Finance

Parliament Appoints New BI Deputy Governors

On November 27, Parliament confirmed the appointments of BI career officials Muliaman D. Hadad and S. Budi Rochadi as BI Deputy Governors. Hadad is currently BI's Director for Banking Regulation and Research, and will replace departing Deputy Governor Maman H. Soemantri. Rochadi, BI's current Director for Banking Supervision, will replace outgoing Deputy Governor Maulana Ibrahim. The appointments become effective January 1, 2007.

BI Issues New Policy Package

On October 5, BI launched a new banking policy package that includes incentives to promote bank consolidation and rules limiting any given individual or organization to a single banking presence in Indonesia. The new rules provide a host of incentives for banks to merge, including granting consolidated banks looser lending limits, lower minimum capital requirements, and relaxed rules for obtaining licenses to conduct foreign exchange operations. The policy package also sets out new definitions for related

parties, redefines the scope of lending limits for related parties, and further clarifies the definition of parties considered “group debtors” by virtue of their financial ties.

Under the new single presence rules, a single party can own controlling interest in only one banking organization. BI defines controlling interest as owning 25% or more of total outstanding shares, or having direct or indirect controlling power. Owners currently in violation of the single presence policy will have to submit a restructuring plan to BI by December 2007, and report quarterly on divestiture progress starting in January 2008. The rules mandate that violators comply with the new regulations by December 2010, but do not specify penalties for non-compliance.

As part of the package, BI also issued a new regulation increasing the number of economic sectors considered “vital to national economic development” for the purpose of bank lending guidelines. Under BI regulation 7/3/2005, BI encourages banks to lend an amount equivalent to 30% of their capital to projects by state-owned enterprises in the food, simple housing, oil and gas (and other energy sources), water, electricity, and transportation infrastructure, including roads, bridges, railways, and ports. The new regulation adds “export oriented commodities” to that list.

GOI Repays IMF Loan Balance

On October 12, Indonesia repaid its entire outstanding SDR 2.1 million (US\$ 3.2 billion) loan balance under its International Monetary Fund (IMF) Extended Fund Facility (EFF), four years ahead of schedule. “This loan settlement is a signal of the increased flexibility of the Government’s fiscal position,” BI Governor Burhanuddin Abdullah stated. A positive market response to Indonesia’s first accelerated IMF loans repayment in June 2006, as well as support by Parliament, prompted the Government to finish paying off its IMF debt. Despite the large repayment, Indonesia’s foreign exchange position remains strong. Analysts estimate that the country’s foreign exchange reserves will remain in the US\$ 39-40 billion range through the end of 2006, a figure equivalent to over four months imports and short-term foreign debt repayments. “We expect this settlement to improve investor confidence, decrease country risk and ultimately increase Indonesia’s credit rating,” added Abdullah.

Government Debt Market Update

The MOF sold Rp 1 trillion (US\$ 109 million) in 2-year treasury bonds at its October 10 auction with a coupon rate of 9.25%. Director of Treasury Bond Management Rachmat Waluyanto said the auction would be the last for 2006 since the MOF has already reached its 2006 financing target of Rp 60.9 trillion (US\$ 6.6 billion). The projected net proceeds (new issuances minus amortizations) from 2006 bond sales total Rp 35.8 trillion (US\$ 3.9 billion).

On October 17, MOF swapped bonds maturing in 2007-2009 totaling Rp 4.3 trillion (US\$ 469 million) for 15-year debt priced to yield 11.03%. On November 21, MOF earned Rp 0.9 trillion (US\$ 98 million) from a similar swap of 8-year bonds with a

coupon rate of 11%. The debt swaps are the latest in a series of MOF operations designed to smooth out the GOI's amortization profile by reducing the amount of bonds maturing in 2007-09.

Indonesia and China Agree On Debt Swap

On October 17, BI and the People's Bank of China signed an "Amendment Agreement" to their Bilateral Swap Arrangement under the Chiang Mai Initiative, raising the limit for short-term bilateral currency swaps from US\$ 2 billion to US\$ 4 billion. The new agreement will enable Indonesia to receive up to US\$ 4 billion in short-term financing from China through a swap mechanism if Indonesia faces short-term liquidity constraints.

Fitch Affirms Ratings for Three Banks

On November 1, Fitch Ratings affirmed the ratings of Indonesia's second largest bank, Bank Central Asia (BCA), fourth largest bank, Bank Rakyat Indonesia (BRI) and seventh largest bank, Bank Niaga. According to the rating agency's website, BCA's ratings reflect its strong financial position, including generally good asset quality and above average capitalization, along with its steady earnings profile. BRI's ratings reflect its strong underlying profitability and above average asset quality, which stem from its largely unchallenged franchise in rural micro credit. Bank Niaga's ratings reflect its reasonably strong profitability, an improved capital position, and parentage in Malaysia's Bumiputra-Commerce Holdings Berhad, the combination of which mitigate a still high level of impaired loans.

Fitch Ratings for BCA, BRI, and Niaga

Long-term foreign currency	
Short-term foreign currency	
National long-term	
Individual	
Support	

Source: www.fitchratings.com

Permata and Lippo Issue Sub-Debt

Indonesia's eighth largest commercial bank, Bank Permata, issued subordinated bonds totaling Rp 500 billion (US\$ 55 million) on November 14. The bonds hold a tenor of five years, with the interest rate of 150-225 basis points above the five years bonds of the government's FR22. FR22 will be matured in 2012, with the interest rate of 12%. The bank announced it would use the proceeds from the issue to finance business expansion, increase its sources of long-term funds and strengthen its capital base. On November 16, Indonesia's ninth largest bank, Lippo Bank, issued US\$ 200 million in subordinated debt carrying a coupon rate of 7.375%.

Selected Economic, Monetary & Financial Statistics

	Aug 06	Sep 06	Oct 06	Nov 06
CPI Inflation (YoY)	14.90	14.55	6.29	5.27
CPI Inflation (MoM)	0.33	0.38	0.86	0.34
Rp/USD Exchange rate ¹	9,100	9,235	9,107	9,140
30-day SBI Interest Rate ²	11.75	11.25	10.75	10.25
Foreign reserves ³	42.0	42.3	39.9	
JSX Composite Index	1,431	1,534	1,583	1,719
Exports (USD billion)	8.9	8.8	8.7	
% Change (YoY)	17.13	16.7	16.4	
Import (USD billion)	5.6	5.7	4.5	
% Change (YoY)	2.6	4.0	3.1	
Trade Balance ⁵	3.3	3.1	4.2	

Source: Bank Indonesia, BPS

(1) Rp/USD, end of period

(2) End of period

(3) USD billions, end of period

(4) Jakarta Stock Exchange average daily transaction volume, in billions of shares

(5) USD billions

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